

# Hamilton County LAW LIBRARY

# NEWS

Professional legal information, services, and education

February 2022

## Section 1202 Planning: When Might the Assignment of Income Doctrine Apply to a Gift of QSBS? By [Scott W. Dolson](#), Frost Brown Todd LLC

Section 1202 allows taxpayers to exclude gain on the sale of QSBS if all eligibility requirements are met. Section 1202 also places a cap on the amount of gain that a stockholder is entitled to exclude with respect to a single issuer's stock.<sup>[i]</sup> A taxpayer has at least a \$10 million per-issuer gain exclusion, but some taxpayer's expected gain exceeds that cap. In our article [Maximizing the Section 1202 Gain Exclusion Amount](#), we discussed planning techniques for increasing, and in some cases multiplying, the \$10 million gain exclusion cap through gifting QSBS to other taxpayers.

<sup>[ii]</sup> Increased awareness of this planning technique has contributed to a flurry of stockholders seeking last-minute tax planning help. This article looks at whether you can "multiply" Section 1202's gain exclusion by gifting qualified small business stock (QSBS) when a sale transaction is imminent.

This is [one in a series of articles and blogs addressing planning issues relating to QSBS](#) and the workings of Sections 1202 and 1045. During the past several years, there has been an increase in the use of C corporations as the start-up entity of choice. Much of this interest can be attributed to the reduction in the corporate rate from 35% to 21%, but savvy found-

ers and investors have also focused on qualifying for Section 1202's generous gain exclusion. Recently proposed tax legislation sought to curb Section 1202's benefits, but that legislation, along with the balance of President Biden's Build Back Better bill, is currently stalled in Congress.

### The Benefits of Gifting QSBS

Section 1202(h)(1) provides that if a stockholder gifts QSBS, the recipient of the gift is treated as "(A) having acquired such stock in the same manner as the transferor, and (B) having held such stock during any continuous period immediately preceding the transfer during which it was held (or treated as held under this subsection by the transferor)." This statute literally allows a holder of \$100 million of QSBS to gift \$10 million worth to each of nine friends, with the result that the holder and his nine friends each having the right to claim a separate \$10 million gain exclusion. Under Section 1202, a taxpayer with \$20 million in expected gain upon the sale of founder QSBS can increase the overall tax savings from approximately \$2.4 million (based on *Cont. p. 4*

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### Hamilton County Law Library

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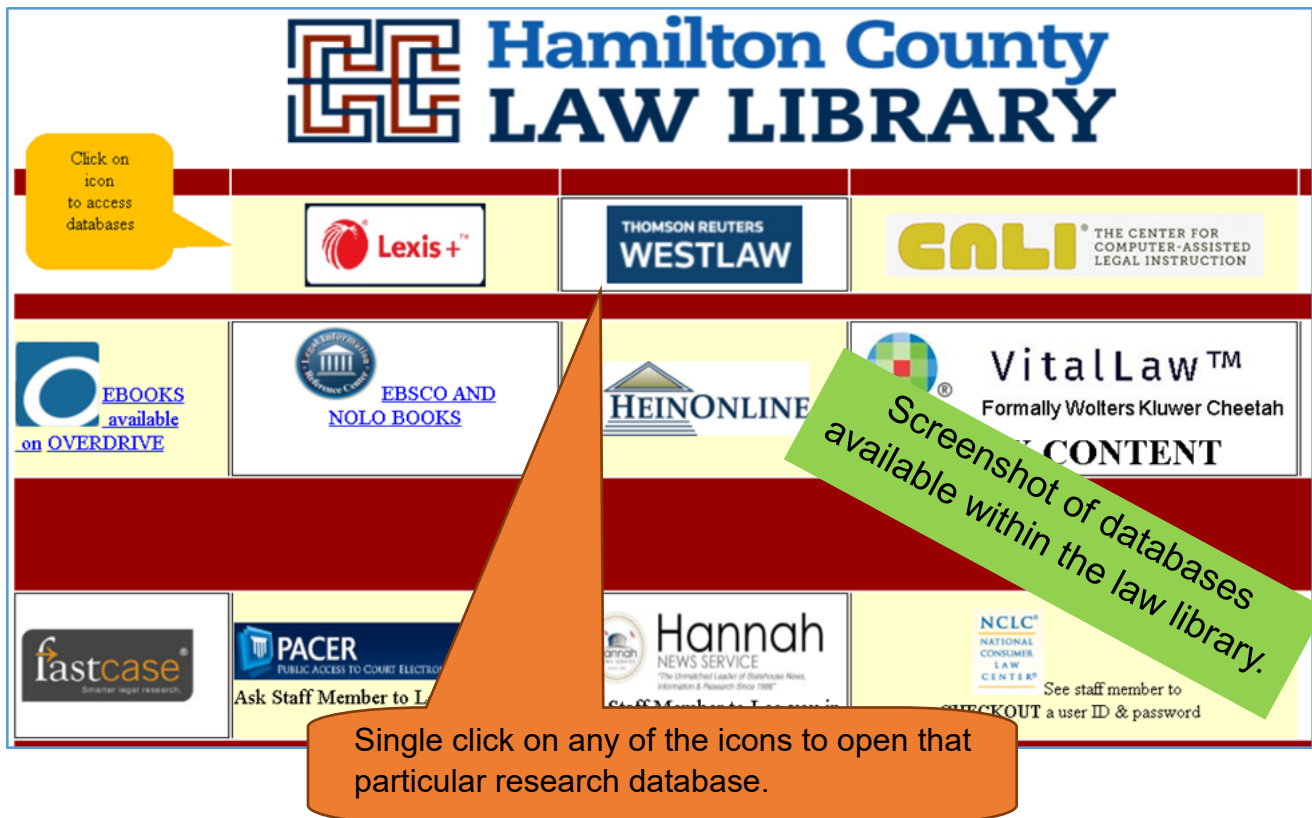
<http://lawlibrary.hamilton-co.org>

M-F 7am-4pm

## Tech Tip: Access to the research databases via HC Law Library by Julie Koehne, Systems Librarian

Depending on where you are and which type of device you are using, here are the various ways to access the research databases the law library provides.

If you are physically in the law library log on to one of our computers in the computer lab using your individual credentials and double click on the Law Library RESOURCES Icon displayed to the right.



You may use your own mobile device within the walls of the Law Library to access Westlaw. Log in to the Law Library website and click on "Go to Database" to get started.

### Westlaw (Use your mobile device with WiFi in Law Library)

Primary law from 50 states and federal. Extensive treatise access, including Baldwin's Ohio and Kentucky Practice Series, ALR, Am Jur, jury verdicts, settlements, and judgments, Restatement of the Law, law reviews, Ohio jury instructions and robust forms library. Westlaw is available to use on your own device or in the computer room, but is only available within in the Law Library. Help: 800.733.2889

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If you are a solo practitioner, subscriber or have a full firm subscription (each attorney in firm is a subscriber), you may access some databases remotely.

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**Westlaw**

Due to the COVID-19 pandemic and thanks to the generosity of Thomson Reuters, the Law Library is pleased to announce remote access to Westlaw is available for a limited time to solo and small firm subscribers! Remote access to the Law Library's full Westlaw subscription, plus, as an added bonus, a free trial of West's Practical Law – try it out and let us know if you like it!

Sign up (here) with instructions on how to sign up. The link to the webpage to sign up is [here](#).

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**HeinOnline**

Comprehensive coverage from inception of more than 1,800 law and law-related periodicals, ALI publications, CFR, Federal Register, U.S. Code, session laws, state statutes, and legal classics. Help: 800.277.6995

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Database of primary and secondary sources related to litigation practice, including discovery, evidence, trial procedures, taxation, and business. Help: 800.344.3734

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Full-text publications, largely from Nolo Press, intended to help individuals to learn about the specifics of the area of law that pertains to their needs and how to address those situations. Help: 800.758.5995

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Currently, due to the COVID-19 pandemic and thanks to the generosity of Thomson Reuters, the Law Library is pleased to announce remote access to Westlaw is available for a 14 day free trial to solo and small firm subscribers!

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NOTE: If you have used your email with Westlaw previously, this trial is not available.

no Federal income tax on \$10 million of QSBS gain) to \$4.8 million (based on no Federal income tax on \$20 million of QSBS gain) by gifting \$10 million worth of QSBS to friends and family.<sup>[iii]</sup>

A reasonable question to ask is whether it is ever too late to make a gift of QSBS for wealth transfer or Section 1202 gain exclusion cap planning? What about when a sale process is looming but hasn't yet commenced? Is it too late to make a gift when a nonbinding letter of intent to sell the company has been signed? What about the situation where a binding agreement has been signed but there are various closing conditions remaining to be satisfied, perhaps including shareholder approval? Finally, is it too late to make a gift when a definitive agreement has been signed and all material conditions to closing have been satisfied?

Although neither Section 1202 nor any other tax authorities interpreting Section 1202 address whether there are any exceptions to Section 1202's favorable treatment of gifts based on the timing of the gift, the IRS is not without potential weapons in its arsenal.

### Application of the Assignment of Income Doctrine

If QSBS is gifted in close proximity to a sale, the IRS might claim that the donor stockholder was making an anticipatory assignment of income.<sup>[iv]</sup>

As first enunciated by the Supreme Court in 1930, the anticipatory assignment of income doctrine holds that income is taxable to the person who earns it, and that such taxes cannot be avoided through "arrangement[s] by which the fruits are attributed to a different tree from that on which they grew."<sup>[v]</sup> Many assignment of income cases involve stock gifted to charities immediately before a prearranged stock sale, coupled with the donor claiming a charitable deduction for full fair market value of the gifted stock.

In Revenue Ruling 78-197, the IRS concluded in the context of a charitable contribution coupled with a prearranged redemption that the assignment of income doctrine would apply only if the donee is legally bound, or

can be compelled by the corporation, to surrender shares for redemption.<sup>[vi]</sup> In the aftermath of this ruling, the Tax Court has refused to adopt a bright line test but has generally followed the ruling's reasoning. For example, in *Estate of Applestein v. Commissioner*, the taxpayer gifted to custodial accounts for his children stock in a corporation that had entered into a merger agreement with another corporation. Prior to the gift, the merger agreement was approved by the stockholders of both corporations. Although the gift occurred before the closing of the merger transaction, the Tax Court held that the "right to the merger proceeds had virtually ripened prior to the transfer and that the transfer of the stock constituted a transfer of the merger proceeds rather than an interest in a viable corporation."<sup>[vii]</sup> In contrast, in *Rauenhorst v. Commissioner*, the Tax Court concluded that a nonbinding letter of intent would not support the IRS' assignment of income argument because the stockholder at the time of making the gift was not legally bound nor compelled to sell his equity.<sup>[viii]</sup>

In *Ferguson v. Commissioner*, the Tax Court focused on whether the percentage of shares tendered pursuant to a tender offer was the functional equivalent of stockholder approval of a merger transaction, which the court viewed as converting an interest in a viable corporation to the right to receive cash before the gifting of stock to charities.<sup>[ix]</sup> The Tax Court concluded that there was an anticipatory assignment of income in spite of the fact that there remained certain contingencies before the sale would be finalized. The Tax Court rejected the taxpayer's argument that the application of the assignment of income doctrine should be conditioned on the occurrence of a formal stockholder vote, noting that the reality and substance of the particular events under consideration should determine tax consequences.

### Guidelines for Last-Minute Gifts

Based on the guidelines established by Revenue Ruling 78-197 and the cases discussed above, the IRS should be unsuccessful if it asserts an assignment of income argument in a situation where the gift of QSBS is made prior to the signing of a definitive sale agreement, even if the company has en-



tered into a nonbinding letter of intent. The IRS' position should further weakened with the passage of time between the making of a gift and the entering into of a definitive sale agreement. In contrast, the IRS should have a stronger argument if the gift is made after the company enters into a binding sale agreement. And the IRS' position should be stronger still if the gift of QSBS is made after satisfaction of most or all material closing conditions, and in particular after stockholder approval. Stockholders should be mindful of Tax Court's comment that the reality and substance of events determines tax consequences, and that it will often be a nuanced set of facts that ultimately determines whether the IRS would be successful arguing for application of the assignment of income doctrine.

### Transfers of QSBS Incident to Divorce

The general guidelines discussed above may not apply to transfers of QSBS between former spouses "incident to divorce" that are governed by Section 1041. Section 1041(b)(1) confirms that a transfer incident to divorce will be treated as a gift for Section 1202 purposes. Private Letter Ruling 9046004 addressed the situation where stock was transferred incident to a divorce and the corporation immediately redeemed the stock. In that ruling, the IRS commented that "under section 1041, Congress gave taxpayers a mechanism for determining which of the two spouses will pay the tax upon the ultimate disposition of the asset. The spouses are thus free to negotiate between themselves whether the 'owner' spouse will first sell the asset, recognize the gain or loss, and then transfer to the transferee spouse the proceeds from the sale, or whether the owner spouse will first transfer the asset to the transferee spouse who will then recognize gain or loss upon its subsequent sale." Thus, while there are some tax cases where the assignment of income doctrine has been successfully asserted by the IRS in connection with transfers between spouses incident to divorce, Section 1041 and tax authorities interpreting its application do provide divorcing taxpayers an additional argument against application of the doctrine, per-

haps even where the end result might be a multiplication of Section 1202's gain exclusion.

### More Resources

In spite of the potential for extraordinary tax savings, many experienced tax advisors are not familiar with QSBS planning. Venture capitalists, founders and investors who want to learn more about QSBS planning opportunities are directed to several articles on the Frost Brown Todd website:

[Planning for the Potential Reduction in Section 1202's Gain Exclusion Section 1202 Qualification Checklist and Planning Pointers](#)

[A Roadmap for Obtaining \(and not Losing\) the Benefits of Section 1202 Stock](#)

[Maximizing the Section 1202 Gain Exclusion Amount](#)

[Advanced Section 1045 Planning](#)

[Recapitalizations Involving Qualified Small Business Stock](#)

[Section 1202 and S Corporations](#)

[The 21% Corporate Rate Breathes New Life into IRC § 1202](#)

[View all QSBS Resources](#)

Contact [Scott Dolson](#) or [Melanie McCoy](#) (QSBS estate and trust planning) if you want to discuss any QSBS issues by telephone or video conference.

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[i] References to "Section" are to sections of the Internal Revenue Code.

[ii] The planning technique of gifting QSBS recently came under heavy criticism in an article written by two investigative reporters. See Jesse Drucker and Maureen Farrell, *The Peanut Butter Secret: A Lavish Tax Dodge for the Ultra-wealthy*. *New York Times*, December

28, 2021.

[iii] But in our opinion, in order to avoid a definite grey area in Section 1202 law, the donee should not be the stockholder's spouse. The universe of donees includes nongrantor trusts, including Delaware and Nevada asset protection trusts.

[iv] This article assumes that the holder of the stock doesn't have sufficient tax basis in the QSBS to take advantage of the 10X gain exclusion cap – for example, the stock might be founder shares with a basis of .0001 per share.

[v] *Lucas v. Earl*, 281 U.S. 111 (1930). The US Supreme Court later summarized the assignment of income doctrine as follows: "A person cannot escape taxation by anticipatory assignments, however skillfully devised, where the right to receive income has vested." *Harrison v. Schaffner*, 312 U.S. 579, 582 (1941).

[vi] Revenue Ruling 78-197, 1978-1 CB 83.

[vii] *Estate of Applestein v. Commissioner*, 80 T.C. 331, 346 (1983).

[viii] *Gerald A. Rauenhorst v. Commissioner*, 119 T.C. 157 (2002).

[ix] *Ferguson v. Commissioner*, 108 T.C. 244 (1997).

**Scott W. Dolson** | Tax

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The scope of Scott's tax practice encompasses tax planning for business formations, ownership arrangements, LLC agreements and M&A transactions. Scott's corporate practice extends to handling M&A transactions, equity compensation arrangements and general corporate law matters. Scott is recognized for his tax planning work with founders, investors, and businesses with respect to their qualified small business stock (QSBS) issues. Scott applies his expertise and experience to assist clients in achieving their business objectives, whether that means limiting an exposure to contingent liabilities or finding the most tax efficient structure for a business transaction. To view Scott's full bio, [click here](#).

## 2022 Subscriber Renewals

Many of our subscribers have renewed for 2022, planning to take good advantage of the Law Library's legal information, services, and education in the year ahead. We mailed statements recently so it's time to remind some of you that we revoke subscriber privileges on March 1 for anyone who hasn't paid by February 28. We hate to do that! We know you value the access to databases, research support, CLEs, and everything else that is bundled into the annual fee, but we have to cut off the service at some point. If you need more information or a replacement invoice, please contact our Library Assistant, [Betsy Weber](#).

Also, keep in mind that we are able to accept credit card payments for subscriber renewals. If you haven't yet renewed and would like to pay by credit card, please email Betsy or the [reference staff](#) and we'll send you the link to our secure site to make your payment.

## Supportworks

The Law Library is pleased to offer access to Supportworks child support software, now available in our computer lab. Per their website, Supportworks is:

Ohio Child Support Guideline Worksheet Software that was developed by an attorney for use by attorneys, child support agencies and the courts in Ohio...This program is current (as of January 1, 2022) with all Ohio statutory provisions and applicable Federal Tax law provisions. It includes all the changes required by the Ohio Department of Job and Family Services worksheet as mandated by Ohio Revised Code §3119.022, as well as the tax law changes resulting from The American Rescue Plan Act of 2021, Pub. L. No. 117-2, pp.156-158 (2021). The program is revised whenever federal or state statutory changes modify the calculation process.

If you're interested in using this in our lab, please just ask a librarian for assistance and we'll be happy to get you started.

## CBA Bundle Renewals

The CBA will be beginning its renewal cycle soon. Please remember to renew your Law Library subscription when you renew your CBA membership if you participated in the HCLL/CBA bundle last year. You should be receiving renewal information from the CBA in the coming weeks. Library subscribers who selected the bundle last year will have until the close of the CBA renewal cycle to renew the bundle for the period of May 2022-May 2023. Please contact [Lauren](#) with any questions.



## VitalLaw

Tax time is coming! Subscribers can access useful tax law information via our online subscription to Wolters Kluwer's VitalLaw (formerly Cheetah). This database provides tax law content from all 50 states and federal as well as tax-related news and secondary source materials. All subscribers can access this on site at the Law Library or by emailing the reference desk to ask us to send you materials. Subscribers in solo practice, in firms with full attorney participation, and our government subscribers can get access to this content remotely in your home, office or anywhere you have access to the internet. For more information please don't hesitate to email us at [reference@cms.hamilton-co.org](mailto:reference@cms.hamilton-co.org).



## Lexis+

Do you like Baldwin's Ohio treatises, but prefer Shepard's for cite-checking? Now you can have both in one location! The Law Library is pleased to announce the addition of Lexis+ to our computer lab. You now have multiple options to access robust legal research databases while working on site at our facility. We continue to offer the same access to Westlaw for our subscribers, and you now have the ability to access Lexis content as well! Subscribers can utilize these on site or can always email or call us for reference assistance. For more information, please don't hesitate to email us at [reference@cms.hamilton-co.org](mailto:reference@cms.hamilton-co.org).

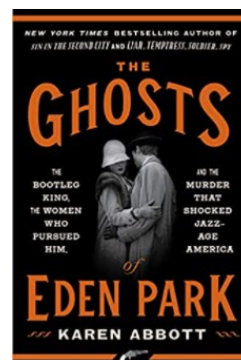
## Upcoming CLEs—Live Interactive Webinars

**Wednesday, March 16, 2021, 12-1 PM**

### Adult Immigrant Integration; Education and Citizenship: Law and Context

Presenter: Mary Joan Reuter, Esq.

1.0 general credit applied in OH, 1.0 general credit applied in KY



## HCLL Book Club

The Hamilton County Law Library Book Club is meeting via Zoom, at 12:00 on Friday, February 25, 2022.

This month's selection is *The Ghosts of Eden Park*, by Karen Abbott.

It is a gripping account of Cincinnati attorney George Remus, the "King of the Bootleggers."

The Cincinnati and Hamilton County Public Library has graciously provided a few print copies of the book for our book club. Please let us know if you would like to reserve a copy, at 513-946-5300.

We are very excited to be able to bring you this opportunity.

And, we look forward to seeing you on the 25<sup>th</sup>!

Sign up for the book club meeting [here](#).

## Subscriber Benefits

All subscribers have access to the following valuable resources and services:

Circulation privileges to borrow from over 40,000 print volumes for up to six weeks at a time

Access to extensive legal information databases from the Law Library, including Lexis+, Westlaw, Wolters Kluwer VitalLaw™, Overdrive e-books, HeinOnline, and Loislaw treatises

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Polycom videoconferencing

Eight meeting rooms with speaker phones

Professional reference service by our law librarians, available via e-mail, telephone, and in person

Free document delivery by fax or e-mail of print and electronic materials

CLE seminars throughout the year, on legal research and substantive topics

Subscribers' lounge, magazines, daily newspapers, and coffee

Bi-weekly news alerts by practice area

Discounted rates for photocopying

In addition, solos and attorneys whose firm has a subscription have 24 hour remote access to Fastcase.com case law, Aspen/LOISLaw treatises, HeinOnline (for under 50 attorney firms), EBSCOhost, and Wolters Kluwer Cheetah™

## CLEs on Demand

The Hamilton County Law Library is proud to announce that we are going to apply for approval for the following self study CLEs to be included in our on-demand library for the year 2022:

**Elder Abuse Awareness** (1.0 general hour in OH)

**Medicaid Planning** (1.0 general hour in OH)

**Complex Appeals in Ohio** (1.0 general hour in OH)

**Fastcase 7** (1.0 general hour in OH)

**Mediation** (1.0 general hour in OH)

**2020 Employment Cases in the US Supreme Court** (1.0 general hour in OH)

**Trademark & Copyright Law in 60 Minutes** (1.0 general hour in OH)

**CHANGE Court** (1.0 general hour in OH)

**Legal Issues & COVID-19** (1.5 general hours in OH)

**What Does Stress Have to Do With it?** (2.5 hours Professional Conduct in OH)

**The Law of Boxing** (1.0 hour in OH, and 1.0 hour in KY until June 30, 2022)

**Implicit Bias & the Criminal Justice System** (1.0 hour Professional Conduct in OH)

**Elder Financial Exploitation & Undue Influence** (1.0 general hour in OH)

**Hamilton County Municipal Court Update** (1.0 general hour in OH)

**We Don't Know We Don't Know: Future Pandemics and Dynamic Decision Making** (1.0 general hour in OH)

**Mindfulness for Professionalism and**

**Civility** (1.0 Professional Conduct in OH)



## Tax Law Resources

Law Library subscribers have access to a variety of Tax Law Resources, including those listed below. If you have questions about these resources, contact the reference staff at [reference@cms.hamilton-co.org](mailto:reference@cms.hamilton-co.org) or 513.946.5300.

Baldwin's Ohio tax law and rules

KFO470.A6 B322

Baldwin's Ohio tax service

KFO470.A6 B324

Bender's tax return manual

KF6369 .B45

Board of Tax Appeals decisions

KFO471.5 .O55

Charitable contributions : income tax aspects

KF6289.A1 .T352 no. 863-3rd

Charitable remainder trusts and pooled income funds

KF6289.A1 T352 no. 865-2nd

Computation of consolidated tax liability

KF6289.A1 T35 no. 756-4th

Distributions from qualified plans: taxation and qualification

KF6289.A1 T35 no. 370-4th

Federal tax forms

KF6335 .C65 T35

IRS tax collection procedures: a manual for practitioners

KF6310 .S37

## Online Resources

### **EBSCO**

Every Landlord's Tax Deduction Guide  
Home Business Tax Deductions  
Tax Deductions for Professionals

### **Fastcase**

S Corporation Taxation

### **HeinOnline**

International Tax Review  
Intertax  
Journal of State Taxation  
Major Tax Planning  
Tax Law Review

### **Lexis+**

Federal Income Taxation of Corporations Filing Consolidated Returns  
Rhoades & Langer International Taxation & Tax Treaties  
Taxation of Securities Transactions  
CCH Tax Treatises

### **VitalLaw**

Federal Estate and Gift Tax Reporter  
Federal Excise Tax Reporter  
Multistate Corporate Tax Guide—Healy and Schadewald  
Practitioner's Guide to IRS Tax Penalties—Collins—Archive  
Tax Research Consultant

### **Westlaw**

Tax-Advantage Securities Handbook  
Tax Law Review  
Tax Lawyer  
Tucker on Tax Planning for Real Estate Transactions  
West Federal Taxation

## Upcoming Events:

Monday, February 21, 2022, Library Closed for Presidents Day

Sunday, February 13, 2022, Superbowl Sunday (Go Bengals!)

Thursday, February 17, 12 pm, The Hamilton County Law Library Resources Board meeting

Friday, February 25, 2022, at 12 pm, HCLL Book Club Meeting, on ZOOM

Wednesday, March 16, 2022, 12-1 PM Interactive Webinar CLE: Adult Immigrant Integration; Education and Citizenship: Law and Context



# February 2022 Law Library Newsletter

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